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Dear Colleague,

Network Code Modification Proposal 0744 *Allocation of Incremental System Entry Capacity at System Entry Points with Descending Price Schedules*

Transco raised network code Modification Proposal 0744 *Allocation of incremental system entry capacity at system entry points with descending price schedules* on 11 February 2005.

Ofgem has carefully considered the views of the respondents to Modification Proposal 0744 and has decided to direct Transco to implement this proposal because it better facilitates the relevant objectives of Transco's Network Code, as set out in standard condition 9 of Transco's Gas Transporters (GT) licence. In making this decision, Ofgem has taken into account Transco's obligations under its GT licence, Ofgem's wider statutory duties and relevant facts.

The background to the proposal and the reasons for the decision are set out below.

Background to the proposal

In December 2003, Ofgem directed Transco to implement 0667 *Allocation of Incremental System Entry Capacity at System Entry Points with Descending Price Schedules*.

Transco completed an extended auction for System Entry Capacity at Milford Haven in December 2004. Consideration of bids placed revealed that application of the present rules to descending price auctions could result in an inappropriately low volume being released.

Transco has raised this proposal because it is of the view that the application of existing Network Code rules would potentially lead to an inefficient allocation of resources with inappropriately low volumes being released in a situation with descending price schedules. The objective of this proposal was to enable capacity allocation to be maximised in instances where users bids are placed against a descending price schedule.

The objective of Modification Proposal 0744 is therefore to better align the Network Code with the intent of Modification 0667.

The Modification Proposal

Aggregate System Entry Points (ASEPs) can have increasing or decreasing price schedules. In the case of decreasing price schedules, the step prices decrease as the corresponding incremental amounts of Quarterly System Entry Capacity (QSEP) offered increase. Modification Proposal 0744 proposes that, for auctions with decreasing price schedules, the quantities on offer should be considered in descending price order with the highest priced first (step price one). It also proposes that the reserve price is included in the price stack.

Once capacity release has been set at a given level, the final allocation would then be assessed with the volume availability and with in effect the price schedule reorganised such that zero priced quantity (reserve price) is placed at the end of a sequence of descending prices (i.e. cheapest last).

Transco argued that this Modification Proposal would enable allocations to be maximised in instances where users have placed large volume bids at the reserve price, with the release of entry capacity continued to be subject to the relevant tests as set out in Transco's Incremental Entry Capacity Release Statement.

Following a request from Transco, Ofgem granted urgency status to the Modification Proposal to limit the period of uncertainty for those Users who have bid in the recent Entry Capacity auctions.

Respondents' views

There were five responses to Modification Proposal 0744. These are available on Transco's Information Services (Nemisys) website. Set out below is a summary of the main issues raised by respondents.

None of the respondents opposed the implementation of this proposal and four respondents were supporting the implementation.

One respondent was concerned that the intention of the proposal might be to change the Network Code in order to bring it into line with Transco's capacity release and allocation model, rather than applying the rules set out in the Network Code and the Incremental Entry Capacity Release (IECR) Methodology. It said that given that the bidding at the terminal would have taken place under one set of assumptions, participants may have reacted differently if the auction had been conducted under a different set of rules.

Other respondents pointed out that the intention of Modification 0667 was to maximise capacity allocation in instances of a descending price schedule. It was argued that the current drafting of the Network Code is not as clearly aligned with the intent of Modification 0667 as it might have been given that the drafting does not actually deliver the intent of maximising capacity release where the entry point has a descending price schedule.

It was stated that Modification Proposal 0744 would enable allocations to be maximised in instances where there is a descending price schedule and would be consistent with the intent of Modification 0667. It was pointed out that Modification Proposal 0744 is consistent with the economic and efficient operation of Transco's system, given that restricting long term capacity releases to a level below capacity availability would potentially create a number of inefficiencies.

Transco's views

Transco, as proposer, supported the implementation of the Modification Proposal. Transco stated that this Modification Proposal is intended to clarify the treatment of bids in descending price auctions and better align the Network Code with the intent of Modification 0667 as it would enable allocations to be maximized in instances where a descending price schedule is published and users may have placed large volume bids at the reserve price.

Ofgem's views

Ofgem agrees that the intention of Modification 0667 was to enable capacity allocation to be maximised in instances where users bids are placed against a descending price schedule. As pointed out by respondents as well as Transco, the current drafting of the Network Code is not as clearly aligned with the intent of Modification 0667 as it might have been.

In Ofgem's view, Modification Proposal 0744 should better align the Network Code with the intent of Modification 0667.

Ofgem's decision

For the reasons outlined above, Ofgem has decided to direct Transco to implement Network Code Modification Proposal 0744 as it better facilitates the relevant objectives of Transco's Network Code under standard condition 9 of Transco's GT licence. In particular, the efficient and economic operation of Transco's pipe-line system.

As a result of implementing this Modification Proposal the capacity allocated pursuant to the September and December 2004 entry capacity auctions at Milford Haven, and capacity allocations at subsequent auctions at entry points with descending price schedules, will be made in accordance with the modified Network Code rules.

If you have any further questions on this letter please do not hesitate to contact me or Nienke Hendriks (tel 020 7901 7329) at Nienke.Hendriks@ofgem.gov.uk.

Yours sincerely



Andrew Walker
Director – Transmission Networks Regulation